

FILE COPY

FILED

MAR 8 1948

CHARLES H. HOPKINS  
CLERK

156

Supreme Court of the United States

OCTOBER TERM, 1947

795431

*Sup. Ct.*

No. 658

THE CANISTER COMPANY,  
*Petitioner,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE  
UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE THIRD CIRCUIT

✓ WESTON VERNON, JR.,  
*Counsel for Petitioner.*

MILBANK, TWEED, HOPE & HADLEY,  
*Attorneys for Petitioner.*

CLARENCE E. DAWSON,  
ROBERT L. MERRITT,  
*Of Counsel.*



# INDEX

	PAGE
PETITION FOR WRIT OF CERTIORARI	
Summary statement of the matter involved .....	1
Jurisdictional statement .....	3
Questions presented .....	3
Statutes involved .....	4
Reasons relied on for allowance of the writ .....	4
Prayer for writ .....	8
Appendix .....	9

## CITATIONS

### Cases:

Brewster Shirt Corp. v. Commissioner, 159 F. 2d 227 (C. C. A. 2, 1947) .....	6, 7
Butterworth-Judson Corp., United States v., 267 U. S. 387 (1925) .....	4, 5
Butterworth-Judson Corp., United States v., 297 Fed. 971 (C. C. A. 2, 1924) .....	4
Claridge Apartments Co. v. Commissioner, 323 U. S. 141 (1944) .....	7
Consolidated Goldacres Co. v. Commissioner, F. 2d (C. C. A. 10, Dec. 12, 1947) .....	5, 6, 7
Crane v. Commissioner, 331 U. S. 1 (1947) .....	7
Dobson v. Commissioner, 320 U. S. 489 (1943) .....	7
McWilliams v. Commissioner, 331 U. S. 694 (1947)	7
Powder Co. v. Burkhardt, 97 U. S. 110 (1877) .....	5

(R. 17a; 20a.) Once the advances were made, the petitioner was unilaterally and unconditionally bound as principal and primary obligor to repay the advances under all circumstances.

The advances to the petitioner were made under authority of Act of June 28, 1940<sup>1</sup> and of the First War Powers Act of 1941.<sup>2</sup> (R. 16a; 19a.) These acts *inter alia* authorized the Secretary of the Navy to make advances to war contractors when such action "would be in the best interests of national defense" or "would facilitate the prosecution of the war," provided "adequate security for the protection of the Government for the payments so made" was furnished by the contractors.

The petitioner treated the Government advances as borrowed capital in computing its excess profits credit on the invested capital basis. (R. 4a.) This could properly be done pursuant to Section 719(a)(1) of the Internal Revenue Code<sup>3</sup> if the Government advances created a debtor-creditor relationship between the petitioner and the Government, and if the "outstanding indebtedness" so created was

"evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust  
• • •."

The respondent excluded the amount of the Government advances from the petitioner's borrowed capital for its fiscal year 1942, thereby increasing the petitioner's "excess" profits for that year. (R. 4a.) He therefore determined a deficiency in the petitioner's excess profits tax in the amount of \$11,704.38, plus interest. On October 16, 1946 the Tax Court of the United States upheld the respondent's determination. (R. 3a; 7 T. C. 367.) The Tax

<sup>1</sup> Chapter 440, Tit. 1, § 1, 54 Stat. 676, 50 U. S. C. App. 1940 ed., § 1151 (1944), set forth in Appendix, *infra* p. 10.

<sup>2</sup> Act of December 18, 1941, c. 593, Title II, § 201, 55 Stat. 839, 50 U. S. C. App. 1940 ed., § 611 (1944), set forth in Appendix, *infra* pp. 10-11.

<sup>3</sup> 54 Stat. 984 (1940), set forth in Appendix, *infra* p. 9.

Court held that the Government advances were not loans giving rise to "outstanding indebtedness" within the meaning of Section 719(a)(1) of the Code, and that the bonds furnished to the Government by the petitioner to secure the repayment of the advances were not "bonds" within the meaning of that Section.

The Circuit Court of Appeals for the Third Circuit affirmed the decision of the Tax Court on January 20, 1948. (R. 27; not yet officially reported.) The Circuit Court of Appeals treated the issues before it as questions of fact and held that under the decision of this Court in *Commissioner v. Scottish American Investment Co.*, 323 U. S. 119 (1944), it was precluded from reviewing the decision of the Tax Court. In the alternative, the Circuit Court of Appeals held that as a matter of law the advance payment bonds were not "bonds" or other proper evidences of indebtedness within the meaning of Section 719(a)(1) of the Internal Revenue Code.

### **Jurisdictional Statement**

Jurisdiction to review this case upon writ of certiorari is expressly conferred upon this Court by Section 1141(a) of the Internal Revenue Code, 53 Stat. 164, and Section 240(a) of the Judicial Code, as amended (Act of March 3, 1891, c. 517, § 6, 26 Stat. 828; Act of March 3, 1911, c. 231, § 240, 36 Stat. 1157; Act of February 13, 1925, c. 229, § 1, 43 Stat. 938; U. S. C. Title 28, § 347).

### **Questions Presented**

1. Whether advances made by the Government to the petitioner, a war contractor, under authority of the Act of June 28, 1940 and of Section 201 of the First War Powers Act of 1941 are, as a matter of law, loans creating "outstanding indebtedness" within the contemplation of Section 719(a)(1) of the Internal Revenue Code.

2. Whether bonds given by the petitioner to evidence the outstanding indebtedness created by the receipt of Gov-

ernment advances and to secure their repayment are, as a matter of law, "bond[s]" or are otherwise evidences of indebtedness within the contemplation of Section 719(a)(1) of the Internal Revenue Code.

3. Whether the advance payment bonds, when considered together with the contract with the Navy Department, are, as a matter of law, evidences of indebtedness within the contemplation of Section 719(a)(1) of the Internal Revenue Code.

### **Statutes Involved**

The pertinent statutes are set forth in the Appendix, *infra*, pp. 9-11.

### **Reasons Relied on for Allowance of the Writ**

This Court is requested to grant the writ for the following reasons:

1. The Circuit Court of Appeals for the Third Circuit held that advances made by the Government to a war contractor under the provisions of the Act of June 28, 1940 and of Section 201 of the First War Powers Act of 1941 are not loans creating outstanding indebtedness. Its decision is in conflict with the decision of this Court in *United States v. Butterworth-Judson Corp.*, 267 U. S. 387 (1925), and with the decision of the Circuit Court of Appeals for the Second Circuit on this point in the same case (297 Fed. 971). This Court (267 U. S. 387, 392, 393), and the Circuit Court of Appeals for the Second Circuit below (297 Fed. 971, 978), there treated advances under the Urgent Deficiency Act of 1917,<sup>4</sup> after which the Act of June 28, 1940 was patterned and whose basic policy is extended by the First War Powers Act of 1941, as creating the relationship "of debtor and creditor" between a war contractor and

<sup>4</sup> Act of October 6, 1917, c. 79, § 5, 40 Stat. 345, 383.

the Government.<sup>5</sup> Further, this Court, in *Powder Co. v. Burkhardt*, 97 U. S. 110 (1877), affirmed a decision that advances made to facilitate the performance of a contract by a contractor were "as a matter of law" (see 97 U. S. 110, 115) loans creating the relationship of debtor and creditor.<sup>6</sup> Although the *Butterworth-Judson Corp.* case was a suit by the Government to enforce an equitable lien and the *Powder Co.* case involved an action for wrongful conversion, the legal principle this Court enunciated in those cases should apply where a corporation's tax liability is at issue.

The Government made numerous advances to war contractors under the provisions of the Act of June 28, 1940 and of Section 201 of the First War Powers Act of 1941. As those or similar Acts would probably be in force should another national emergency develop, it is urgent that the nature of such advances be settled by this Court. Not only is this issue of importance to the petitioner, as well as to similarly situated war contractors, but the creditor's rights of the Government (*cf. United States v. Butterworth-Judson Corp., supra*) have been made uncertain, thus inviting litigation which consideration of the instant case by this Court would avert.

2. The Circuit Court of Appeals for the Third Circuit relied upon *Consolidated Goldacres Co. v. Commissioner*,<sup>7</sup>

F. 2d (C. A. A. 10, Dec. 12, 1947), when holding that the advance payment bonds furnished by the petitioner pursuant to the specific provisions of the Navy contract were not "bonds" or other evidences of indebted-

<sup>5</sup> Advances made under these Acts were in practice treated as loans by the Navy Department. For example, as to advances made after April 10, 1942, an interest charge of 2½% per annum was made "for the use of the Government money so furnished." Navy Procurement Directives, para. 12,231.

<sup>6</sup> See also *Summit Coal Co.*, 18 B. T. A. 983 (1930), *acq.* IX-2 Cum. Bull. 58 (1930).

<sup>7</sup> *Consolidated Goldacres Co. v. Commissioner, supra*, held that a "contract of conditional sale" is not an "outstanding indebtedness" evidenced by a "note," "mortgage" or other type of instrument contemplated by Section 719(a)(1) of the Internal Revenue Code.

ness within the meaning of Section 719(a)(1) of the Code. This narrow interpretation does "violence to the language" of the Statute (cf. *Trust of Bingham v. Commissioner*, 325 U. S. 365, 382 (1945) (concurring opinion) ), for the bonds securing the Government's advances were a type of bond in general use. In the *Consolidated Goldacres Co.* case the Tenth Circuit admitted that its narrow construction of Section 719(a)(1) is irreconcilable with the more natural interpretation of that Section by the Second Circuit in *Brewster Shirt Corp. v. Commissioner*, 159 F. 2d 227 (C. C. A. 2, 1947). This conflict in statutory interpretation should be resolved by this Court. The conflict makes uncertain both the meaning of Section 719(a)(1) and the meaning of the term "bond" wherever it appears in the Internal Revenue Code.

The Second Circuit determined in *Brewster Shirt Corp. v. Commissioner*, *supra*, that it was not the intention of Congress when it enacted Section 719(a)(1) to subject "persons of only moderate financial strength who cannot obtain the money they need from commercial banks" to "burdensome excess profits taxes" (159 F. 2d at 229). It therefore held that certain factoring agreements and assignments of accounts receivable made in connection therewith were a "mortgage" as "a matter of substance" within the contemplation of Section 719(a)(1) of the Code, even though not a mortgage in form. The spirit of the Second Circuit's decision requires that the secured Government advances here involved likewise be treated as borrowed capital for excess profits tax purposes.

The interpretation of Section 719(a)(1) of the Code by the Third Circuit places a disproportionately heavy tax burden upon those comparatively small companies whom the Government financed during the war through advances, adequately secured, such as were made to the instant petitioner.

3. When originally introduced in Congress as H. R. 10413, the Second Revenue Bill of 1940 defined "borrowed capital" as "outstanding indebtedness \* \* \* of the



taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust". This phrasing remained unchanged during the entire course of the Bill's journey through Congress and ultimate enactment. The House Ways and Means Committee, in its report on the Bill, considered the above definition of "borrowed capital" as including in its scope "any other written evidence of indebtedness" in addition to the specifically named instruments.<sup>8</sup> Section 719(a)(1), so interpreted, clearly encompasses the bonds given by the petitioner to unconditionally secure the repayment of the Government advances. The conditions of the Statute are met whether such bonds are considered alone or in conjunction with the provisions of and limitations in the Navy contract. *Cf. Brewster Shirt Corp. v. Commissioner, supra.*

4. The question whether Government advances made under the provisions of the Act of June 28, 1940 and of Section 201 of the First War Powers Act of 1941 are loans creating outstanding indebtedness "is one of law and of a sort not requiring the specialized experience of the Tax Court to determine." *Cf. Claridge Apartments Co. v. Commissioner*, 323 U. S. 141, 145 (1944) (interpretation of bankruptcy laws). Thus, the determination of the Tax Court and of the Circuit Court of Appeals on this issue is reviewable by this Court. Moreover, the meaning to be given to the term "bond" in Section 719(a)(1) of the Code presents a clear-cut question of law, which this Court may consider upon review. *Crane v. Commissioner*, 331 U. S. 1, 15 (1947); *McWilliams v. Commissioner*, 331 U. S. 694, 703 (1947); *Commissioner v. Wilcox*, 327 U. S. 404, 410 (1946); *Trust of Bingham v. Commissioner*, 325 U. S. 365, 370-371 (1945); *Brewster Shirt Corp. v. Commissioner*, 159 F. 2d 227 (C. C. A. 2, 1947); *Consolidated Gold-acres Co. v. Commissioner*, F. 2d (C. C. A. 10, Dec. 12, 1947); cf. *Dobson v. Commissioner*, 320 U. S. 489, 502

<sup>8</sup> H. R. Rep. 2894, 76th Cong., 3rd Sess., p. 26, accompanying H. R. 10413 (Union Calendar No. 1071).

(1943); *Commissioner v. Scottish American Investment Co.*, 323 U. S. 119, 123 (1944).

The issues of law in this case are of broad implication. Clarification of when a bond is a "bond" for tax purposes is of importance to the proper administration of the tax laws, for the Internal Revenue Code contains no definitive guide. Moreover, the obligations incurred by contractors who received Government advances to finance and thus facilitate war production, and the creditor's rights of the Government in regard thereto, are indeed matters of wide interest. The decision of the Circuit Court of Appeals below on these issues conflicts with decisions of this Court and of the Circuit Court of Appeals for the Second Circuit. These conflicts should be resolved by this Court upon review.

### **Prayer for Writ**

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court to the United States Circuit Court of Appeals for the Third Circuit commanding said last named Court to certify and send to this Honorable Court a full and complete transcript of the record of all proceedings in the within cause and to stand to and abide by such order and direction as to your Honors shall seem meet and the circumstances of the case require and that your petitioner may have such other and further relief or remedy in the premises as to this Court may seem proper.

Dated: New York, N. Y., March 4, 1948.

WESTON VERNON, JR.,  
*Counsel for Petitioner.*

MILBANK, TWEED, HOPE & HADLEY,  
*Attorneys for Petitioner,*  
15 Broad Street,  
New York 5, N. Y.

CLARENCE E. DAWSON,  
ROBERT L. MERRITT,  
*Of Counsel.*

## Appendix

### Internal Revenue Code:

SEC. 719 [as added by Sec. 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974].

#### BORROWED INVESTED CAPITAL.

(a) *Borrowed Capital*.—The borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

(1) The amount of the outstanding indebtedness (not including interest, and not including indebtedness described in section 751 (b) relating to certain exchanges) of the taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust, plus,

(2) In the case of a taxpayer having a contract (made before the expiration of 30 days after the date of the enactment of the Second Revenue Act of 1940) with a foreign government to furnish articles, materials, or supplies to such foreign government, if such contract provides for advance payment and for repayment by the vendor of any part of such advance payment upon cancellation of the contract by such foreign government, the amount which would be required to be so repaid if cancellation occurred at the beginning of such day, but no amount shall be considered as borrowed capital under this paragraph which has been includible in gross income.

(b) *Borrowed Invested Capital*.—The borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be an amount equal to 50 per centum of the borrowed capital for such day.

(26 U. S. C. 1940 ed., Sec. 719.)

. . . . .

**Act of June 28, 1940** [Chapter 440, Title 1, § 1, 54 Stat. 676]:

**ADVANCE AND PARTIAL PAYMENTS ON DEFENSE CONTRACTS; LIEN  
ON PAYMENTS; REPORT TO CONGRESS**

Whenever in the opinion of the President of the United States such course would be in the best interests of national defense during the national emergency declared by the President on September 8, 1939, to exist, the Secretary of the Navy, or the Secretary of the Treasury in the case of Coast Guard contracts, is authorized to advance, from appropriations available therefor, payments to contractors in amounts not exceeding 30 per centum of the contract price, upon such terms as such Secretary shall prescribe, and adequate security for the protection of the Government for the payments so made shall be required. The Secretary concerned is further authorized in his discretion to make partial payments on the balance of the contract price from time to time during the progress of the work, such partial payments not to exceed the value of the work already done, but to be subject to a lien as provided by the Act of August 22, 1911 (37 Stat. 32; 34 U. S. C., § 582), entitled "An Act authorizing the Secretary of the Navy to make partial payments for work already done under public contracts": *Provided*, That the Secretary concerned shall report every three months to the Congress the advance payments made under the authority of this section.

(50 U. S. C. App. 1940 ed., Sec. 1151.)

• • • • •

**First War Powers Act of 1941** [Act of December 18, 1941, c. 593, Title II, § 201, 55 Stat. 839]:

**WAR CONTRACTS EXEMPT FROM CERTAIN RESTRICTIONS UPON  
AUTHORIZATION BY PRESIDENT**

The President may authorize any department or agency of the Government exercising functions in connection with the prosecution of the war effort, in accordance with regula-

tions prescribed by the President for the protection of the interests of the Government, to enter into contracts and into amendments or modifications of contracts heretofore or hereafter made and to make advance, progress and other payments thereon, without regard to the provisions of law relating to the making, performance, amendment, or modification of contracts whenever he deems such action would facilitate the prosecution of the war: *Provided*, That nothing herein shall be construed to authorize the use of the cost-plus-a-percentage-of-cost system of contracting: *Provided further*, That nothing herein shall be construed to authorize any contracts in violation of existing law relating to limitation of profits: *Provided further*, That all acts under the authority of this section shall be made a matter of public record under regulations prescribed by the President and when deemed by him not to be incompatible with the public interest.

(50 U. S. C. App. 1940 ed., Sec. 611.)